Market update

The new year began on a positive note, with markets carrying the vaccine inspired optimism of late last year into most of January, before running out of steam in the latter part of the month. Post the inauguration of President Biden investors took stock of events and ultimately concluded that many markets had run too far ahead of themselves. Buying enthusiasm began to wane and profit taking became the dominant feature of the last trading week, a process that was widespread and strong enough to tip most indices into the red for the month as a whole.

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The signs that markets where perhaps overbought in relation to reality had been around for a while. Many headlines were generated about the influence in retail investors in everything from smaller company technology shares, to crypto currencies, to gold and silver prices. Whilst retail over exuberance is nothing new, it did serve to highlight to us just how noisy markets had become, leaving prices vulnerable to a setback, should anything more substantive emerge to drive sentiment. In the end there wasn't a particular catalyst for the retreat, just a gradual petering out of upward momentum in the absence of additional positive news.

The key negative of the month was probably the recognition that the ramp up in vaccine manufacturing really will take time and although the UK is off to a good start, most other Western nations are not. Political leaders are also still very reluctant to take the brakes off lockdowns and the difficulties of collating accurate economic data means that investors are guessing more than usual when they try to price markets for future outcomes. Given the amount of stimulus and support already in the financial system, there is some justified scepticism around how much more could realistically be made available. President Biden's eye-catching plans for an additional $1.9trn of stimulus has already attracted the first 'tie breaking' vote in Congress, reminding us that not every positive headline will have an easy path to impacting in the real world.

Outlook and portfolio positioning

In the end, the up and down nature of January is likely to be illustrative of what we can expect in the shorter term. The positive influences of government support and the vaccine roll out will tussle with high valuations and difficult economic conditions to drive market sentiment. There is nothing yet to derail our core view that the positives will outweigh the negatives this year, although it will take until the second half of the year before we can realistically expect evidence that shutdown economies are recovering as rapidly as we and consensus expect.

In the interim, there will be a choppy period with a mosaic of different assets and geographies all moving at different speeds against a general backdrop of recovery. The biggest risk in the real world is that lockdowns continue, forced by low vaccination rates or reduced effectiveness. Given the range of options available neither of those outcomes seems likely, although we should expect our fair share of setbacks as well as advances.

The biggest risk in the financial world is probably unanticipated inflation, which could upset an expensive bond market and then ripple unhelpfully across everything else. Here we lean towards the view that short term inflation is largely anticipated and that the conditions needed for problematic long-term inflation aren't convincingly in place, certainly to the extent that central banks would lose control over them.

We keep a close eye on these and other risks and will adapt portfolios if we think our central case is changing, but for the moment we still think it is correct to remain modestly positive on the year ahead.

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Portfolio performance

Portfolios delivered between -1.2% to +0.5%, with the higher risk bands holding up slightly better, due to their higher exposures to Emerging and Asian stock markets, both of which held on to some positive gains despite the profit taking described above. Positions in convertible bond managers also performed well, as their hybrid risk characteristics make them good vehicles for grinding out returns steadily in a choppy environment. Gold and precious metals were weak, as were corporate bond markets which gave back some of their policy assisted gains from the previous year. This is a process that we not only regard as healthy and but one which should help our managers show their skills in selecting the best individual ideas for the year ahead and beyond.

David Cooke
On behalf of the Saltus Investment Committee, January 2021